The REIT Response to the Pandemic

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Throughout the duration of the coronavirus pandemic, markets have experienced an alarming amount of volatility. Alongside this market volatility, the economy has also been impacted by widening credit spreads, rising unemployment rates, earnings and dividends being lowered or cut, and an overall contraction in the market. With economies that have not fully reopened yet and many corporations having turned to remote working environments, how will Real Estate Investment Trusts (REITs) hold up?

Real Estate Investment Trusts (REITs) are funds comprised of companies that own and operate real estate that generates income. The type of real estate included in a REIT portfolio is broad and can range from malls and apartment buildings to hotels and cellular towers. REITs operate similarly to mutual funds and were created to allow investors to pool capital for the purpose of owning and receiving dividend payments on real estate. Investments in REITs are especially important for investors seeking income from their portfolios. Holding real estate is also a way for investors to hedge against risk. Thus, the impact of the COVID-19 pandemic on the REIT market is substantial. Income-oriented investors and those close to, or in, retirement, must adapt to the volatile market surrounding assets that should be providing supplemental income.

THE PANDEMIC'S AFFECT

The initial concern with REITs during the coronavirus pandemic was whether customers would be able to pay rents to the landlords over the duration of the shutdown. In the retail industry, it was expected that only between 30% and 50% of rents for shopping centers would be paid in April. A study done by Nareit, including private and public rent disclosures, found this to be accurate, with 47.1% of shopping center tenants having paid rent. Additionally, REITS with healthcare, office, and apartment tenants have been collecting most of their rents, with some disparity. As the data suggests, not as many tenants have been delaying payments as was expected. This is attributed to the stronger balance sheets of the tenants, and the ability of some sectors to withstand a crisis. With states reopening their economies, even businesses that are tied to their physical locations have adapted to these new conditions, and have been able to provide safer environments for both employees and customers.

In response to the fastest drop into a bear market ever, from the market high on February 12, 2020 to the 20% drop on March 11, 2020, REITs have performed much like they did in the 2008 recession. The most significant difference this time around is that REIT balance sheets are significantly stronger, with historically low leverage (32% compared to 63% in 2008).

Thus far, REITs have not sustained as well as expected, in part due to tightening credit and weaker property fundamentals. Although REITs have been faring better since the end of the second quarter, they have not been able to make up the huge losses from the start of the pandemic. For example, when all non-essential businesses shut down, the REITs most adversely affected were hotels/gaming, senior housing, retail, offices, and entertainment/food. Many brick-and-mortar retailers were already in trouble due to the increase in e-commerce, and the pandemic has only made the situation more dire. Sheltering in place exasperated demand and, thus, retail suffered greatly. On the other hand, there have also been some REITs that have done relatively well, including industrial, hospitals/medical offices and cell towers/data centers, mostly due to a sharp increase in demand for the services they provide.

WHAT HAPPENS NEXT?

There is much speculation as to how REITs will be affected, as economies look to fully reopen. Aside from the financial struggles, which are being handled mostly by cost-cutting methods, heightened fear for health and safety among employees and customers has become an issue. Businesses are forced to address these concerns at their expense, while revenue declines. In addition to this, as corporations and office start to reopen, those who have adapted to working from home and have found it efficient are left with uncertainty about returning to physical offices. This may prove a longer-term cost reduction opportunity for many businesses. The resulting effect on REIT securities is that many are trading at a discount to net asset value (the value of an entity's assets minus the value of its liabilities). Pre-crisis, most of the REIT sectors, except for regional and strip malls, were trading at a premium to net asset value.

The securities pay out most of the rental income and therefore tend to have an above average dividend yield. In a low interest rate environment, many investors look to buy REITs to supplement income not fulfilled by fixed income securities. REITs are an attractive option as they are meant to provide extra income without the burden of owning real estate. The pandemic has given way to instability within the REIT market and has disrupted many investors that want or need income-generating assets.

CONCLUSION

The effects of COVID-19 are set to have long lasting impact on the market as a whole. With a significant hit to REITs and reduced or suspended dividend payouts in other industries, investors seeking additional income have found themselves in a precarious position. The duration and severity of the situation is yet to be known, especially with talks of a second wave of the virus; thus, it will be important to watch how REIT portfolios perform as states begin to fully reopen.

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